IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

No. 75-668

AMERICAN INVESTMENT COMPANY, DONALD L. BARNES, JR., HARRY W. HARTLEY, ALBERT L. LETOURNEAU, WARREN E. VAN NORMAN, WALTER C. HAEUSSLER, ERWIN A. STUEBNER, R. BRUCE SNOW, NORFLEET H RAND, W. BENTON McMILLAN, BASIL L. KAUFMANN, HENRY R. BARBER, H. REID DERRICK, ALBERT J. O'BRIEN, CHARLES F. BURNS and HASKINS & SELLS,
Petitioners,

vs.

MYRON HARRIS,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals
For the Eighth Circuit

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PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals
For the Eighth Circuit

Petitioners respectfully pray that a Writ of Certiorari be issued to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in this action on June 18, 1975, and modified on August 11, 1975.

OPINIONS BELOW

The memorandum opinion of the United States District Court for the Eastern District of Missouri is reported at 378 F.Supp. 894 and reprinted in Appendix A hereto. The original opinion of the three-judge panel of the United States Court of Appeals

for the Eighth Circuit is reprinted in Appendix B. In response to timely petitions for rehearing, the panel filed a modified opinion, which is reprinted in Appendix C, and an Order denying the petitions for rehearing, which is reprinted in Appendix D. The Court of Appeals' opinion has not been officially reported as of the date of the filing of this petition.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

The original opinion of the three-judge panel of the Court of Appeals was filed on June 18, 1975. In response to petitioners' timely petitions for rehearing or rehearing *en banc*, the panel modified its original opinion and denied the petitions in all other respects on August 11, 1975. This petition for a Writ of Ceriorari has been filed within 90 days of August 11, 1975, as required by Rule 22(1). *Department of Banking v. Pink*, 317 U.S. 264 (1942); *United States v. Healy*, 376 U.S. 75 (1964).

QUESTIONS PRESENTED

1. Under Sections 10(b) and 18(a) of the Securities Exchange Act of 1934, does an allegedly defrauded purchaser of securities have any duty to mitigate his damages?

2. Under Sections 10(b) and 18(a) of the Securities Exchange Act of 1934, should damages to an allegedly defrauded purchaser continue to be measured as of the date of his purchase or as of some later date when the market price of the securities would be influenced by a myriad of factors other than the alleged fraud?

STATUTES AND REGULATIONS INVOLVED

This case involves important questions concerning the measure of damages in litigation based upon Sections 10(b) and 18(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78r(a) (1970), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1975), which are reprinted in Appendix E.

STATEMENT OF THE CASE

This is a claimed class action seeking damages for alleged violations of Sections 10(b) and 18(a) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. §§ 78j(b) and 78r(a) (1970), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1975).

Myron Harris, plaintiff-respondent, and two others[1] filed the action on April 9, 1971 against American Investment Company ("AIC"), officers and directors of AIC, and Haskins & Sells (AIC's independent certified public accountant), all of whom are petitioners here. The case was filed in the United States District Court for the Eastern District of Pennsylvania and was transferred to the Eastern District of Missouri pursuant to defendants' motions based upon 28 U.S.C. § 1404(a).[2]

After transfer of the case, defendants filed motions to dismiss. On December 29, 1972, the district court sustained these motions and granted leave to plaintiffs to file an amended complaint.

On February 1, 1973, plaintiff filed an amended four-count complaint. In Counts I and II, plaintiff alleged that all of the

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[1] The original plaintiffs were Arthur B. Harris, Myron Harris and Milton Weissman. Only Myron Harris, respondent herein, remained a plaintiff when the amended complaint was filed.

[2] The memorandum and order on the transfer is reported at 333 F.Supp. 325.

defendants had violated Sections 10(b) and 18(a) of the Act and Rule 10b-5 (App. 2-3). Plaintiff alleged that he purchased 1,000 shares of the common stock of AIC on August 4, 1969 and still retained the stock (App. 8); asserted numerous allegedly false statements or material omissions in documents uttered by AIC or filed by it with the Securities and Exchange Commission and the New York Stock Exchange beginning on or before June 30, 1968 (App. 2-3); claimed that he suffered a substantial decline in the market values of the AIC stock retained by him; and prayed for damages based upon that decline in value.

In Count III, plaintiff alleged a failure of defendants, other than Haskins & Sells, to disclose merger proposals from other corporations commencing in 1968 and continuing in 1969 (App. 5).

In Count IV, brought as a stockholder's derivative action, plaintiff alleged mismanagement by the defendant officers and directors (App. 3).

Defendants filed motions to dismiss or strike all counts of the amended complaint and motions for summary judgment on Counts I and II. The motions for summary judgmet were based upon the following uncontroverted facts: Plaintiff purchased his 1,000 shares of AIC common stock on August 4, 1969 at a price of \$18⅞ per share. From the date of plaintiff's purchase through May 31, 1971, AIC common stock sold on the New York Stock Exchange at his purchase price or higher on 47 days. Within the one-month period after plaintiff filed this action on April 9, 1971, the stock sold at his purchase price or higher on eighteen days (App. 9).

On June 24, 1974, the district court (Hon. Roy W. Harper) granted defendants' motions for summary judgment with respect to Counts I and II.* The district court stated:

* The Memorandum Opinion is reported at 378 F.Supp. 894 and reprinted in Appendix A.

"The defendants' contention is that the undisputed facts in this case disclose that plaintiff has not suffered any damages as a result of any alleged wrongdoing of the defendants because subsequent to plaintiff's purchase of his AIC common stock and subsequent to the filing of this lawsuit, plaintiff could have recouped his investment or sold at a profit on the open market: therefore, entitling defendants to summary judgment in their favor on Counts I and II. With this contention the Court agrees" (App. 9).

Judge Harper then held, in part, that "Plaintiff's loss, if any, did not flow directly from the purchase or sale of the AIC stock, but flowed from plaintiff's own investment decision to retain the AIC stock" (App. 10), and:

> "Plaintiff's loss was not in connection with the purchase of his AIC stock because he had numerous opportunities to sell without a loss after he discovered the alleged fraud, and plaintiff's loss was not in connection with the sale of his AIC stock because of his investment decision to retain the stock" (App. 11).

The district court also held that plaintiff had a duty to mitigate his claimed damages:

> "Even in cases of alleged fraud, a plaintiff has a duty to mitigate his damages upon discovery of the fraud. * * * Plaintiff in our present cause had eighteen opportunities to sell his stock at the price he paid for it or at a profit within the first month after he filed suit. The only reason plaintiff gives for not selling his AIC stock is that if he had done so he would have lost his standing to pursue a derivative action on behalf of the AIC. This was a personal decision and not the result of any alleged fraud on the part of any of the defendants" (App. 10).

Plaintiff appealed from the judgment of the district court. On June 18, 1975, the three-judge panel of the Court of Appeals

filed its original opinion reversing the judgment of the district court.[4] The panel held, in part: (1) "[T]he public discovery of the fraud is the proper date at which to ascertain damages (App. 21) and "the value of [plaintiff's] AIC stock, for purposes of computing damages, *must* be measured by the market price after the fraud had been discovered by the general public . . ." (App. 23);[5] and (2) "[Plaintiff] was under no duty to sell his AIC stock, for mitigation of damages or any other purpose, prior to commencing this action" (App. 24) and he was not "under a duty, after discovery of the fraud, to sell his AIC stock for the benefit of the appellees" (App. 25).

Defendants then filed timely petitions for rehearing or rehearing *en banc*. On August 11, 1975, the Court of Appeals denied rehearing. The panel, however, modified its opinion with respect to the date upon which damages should be measured, as follows:

> "[U]nder the allegations made in the instant case the public discovery of the fraud *may* be the proper date at which to ascertain damages.
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> * * * * * * *
>
> "Thus, assuming, arguendo, the truth of [plaintiff's] claims that the actual value of the securities cannot be established at or near the date of purchase due to an artificially inflated market price of long duration attributable to defendants' fraudulent misrepresentations, [plaintiff] may be able at the trial to establish an alternate basis for recovery by introducing evidence of his damages as of the date of public discovery of the fraud" (App. 37, 39).

The panel did not modify its original holding that a plaintiff in a Federal securities case has no duty to mitigate his claimed damages.

[4] The Court of Appeals "resolve[d] the merits only with respect to . . . counts I and II" (App. 16) and only these counts are involved in this petition. Plaintiff did not appeal from the dismissal of Count III. The dismissal of Count IV (on the grounds plaintiff failed to allege that he was a shareholder at the time of the claimed wrongs, as required by Rule 23.1, F.R.Civ.P) was not reached on appeal.

[5] Emphasis ours here and throughout this petition unless otherwise noted.

REASONS FOR GRANTING THE WRIT

This Court should grant a Writ of Certiorari and review the decision of the Court of Appeals because:

(1) The decision creates an unprecedented, unwarranted, and far-reaching exception to the universally applied common law doctrine of mitigation of damages by holding that the doctrine is uniquely inapplicable to Federal securities cases based upon Sections 10(b) and 18(a), which ruling conflicts with those of the other courts, including the Ninth Circuit, which have addressed the issue; and

(2) The decision adopts or recommends an equally novel, erroneous, and far-reaching rule that the date of public discovery of the alleged fraud is the proper date at which to ascertain damages in Federal securities cases, which ruling also conflicts with those of all other Circuits which have addressed the issue.

I. The Court Should Grant a Writ of Certiorari Because the Court of Appeals Erred in Holding That the Universally Applied Common Law Doctrine of Mitigation of Damages Is Uniquely Inapplicable to Federal Securities Cases Based Upon Sections 10(b) and 18(a) and That Ruling Conflicts With Those of the Other Courts Which Have Addressed the Issue.

The district court granted summary judgment on the grounds that the uncontroverted facts established that plaintiff had not

been damaged because he had the opportunity on numerous occasions, both before and after filing suit, to mitigate his claimed damages by selling his stock at his purchase price or at a profit. The Court of Appeals held, however, that a plaintiff has no duty to mitigate his damages in a Federal securities case. In so holding, the Court rejected (a) the universally applied common law doctrine that a failure to mitigate damages prevents recovery of such damages as might have been avoided by reasonable effort, whether the action is based upon contract (e.g., *Industrial Sugars, Inc. v. Standard Accident Ins. Co.*, 338 F.2d 673, 676 (7th Cir. 1964); *Commodity Credit Corp. v. Rosenberg Bros. & Co.*, 243 F.2d 504, 511-12 (9th Cir. 1957), *cert. denied*, 355 U.S. 837 (1957), or tort (e.g., *George Cohen Sons & Co. v. Koch*, 376 F.2d 629, 632 (1st Cir. 1967); *Ellerman Lines, Ltd. v. President Harding*, 288 F.2d 288, 290 (2d Cir. 1961), including fraud (e.g., *Southwestern Packing Co. v. Cincinnati Butchers' Supply Co.*, 139 F.2d 201, 208 (5th Cir. 1943)); (b) its own prior decision that where the out-of-pocket rule of damages is applied in fraud cases, there is a duty to mitigate damages (*Lack Industries, Inc. v. Ralston Purina Co.*, 327 F.2d 266, 281 (8th Cir. 1964));[6] and (c) its own prior decision that the Act does not promote speculation at the "total risk" and "expense" of the defendant (*Myzel v. Fields*, 386 F. 2d 718, 740-41 n.15 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968)). Furthermore, the court's decision conflicts with the decisions of the other Circuits and district courts, which hold that there is a duty to mitigate damages in Federal securities cases.

For example, in *Foster v. Financial Technology Inc.*, 517 F. 2d 1068, 1072 (9th Cir. 1975), a case based upon Section 10(b) and Rule 10b-5 of the Act, and Section 5 of the Securities Act of 1933, the Court held:

[6] The Court of Appeals observed in that earlier case, "Since the representer is not a guarantor, the victim of misrepresentation may not irresponsibly accumulate his losses to the detriment of the misrepresentor".

> "Under the familiar mitigation of damages principle, a party cannot recover that part of his loss caused by his own failure, once he has reason to know of the breach, to take reasonable steps to avoid further harm. Although plaintiffs are not here asserting a breach of contract claim, the notion of what constitutes reasonable conduct by the nonbreaching party carries over to the determination of the amount of plaintiffs' loss for which defendants should be held responsible. Consequently, at the point where a reasonable man—either because of the breach or discovery of the fraud—would have taken action to protect himself from further depreciation in the value of the claim, the chain of causation is cut and plaintiffs cannot recover damages for subsequent losses."

See also, *Mitchell v. Texas Gulf Sulfur Co.*, 446 F.2d 90, 105-06 (10th Cir.), *cert. denied*, 404 U.S. 1004 (1971) (Stockholder given reasonable amount of time within which to " 'cover' by reinvestment" thereby suffering "neither loss nor forced sale" and denying "recovery to those who suffered only by their own lack of due diligence"); *Competitive Associates, Inc. v. International Health Sciences, Inc.*, CCH Sec. L. Rptr. ¶ 94,966 at 97,339 (S.D.N.Y. 1975); *Courtland v. Walston & Co., Inc.*, 340 F.Supp. 1076, 1079-80 (S.D.N.Y. 1972); *Pearlstein v. Scudder & German*, 346 F.Supp. 443 (S.D.N.Y. 1972); *Marth v. Industrial Incomes Inc. of North America*, 290 F.Supp. 755, 759 (S.D.N.Y. 1968) ("If indeed plaintiffs, upon learning of the alleged misrepresentations, and prior to entering into the agreement with [defendant], could have sold their shares for a price equal to or greater than their purchase price and failed to do so, they should properly bear the consequences"); *Pfanenstiel v. Ling & Co.*, 371 F.Supp. 845, 848 (N.D.Tex. 1974) (In action brought under the securities acts of 1933 and 1934, even if alleged misrepresentations were part of a scheme to defraud, plaintiff could not recover for damages he could have mitigated by liquidating his account); but see *Chris-Craft In-*

dustries, Inc. v. Piper Aircraft Corp., 480 F.2d 341 (1973) (Section 14(e) of the Act).

The panel of the Court of Appeals did not cite these cases, let alone attempt to distinguish them.

The three cases cited by the panel of the Court of Appeals as supporting its holding that there is no duty to mitigate damages in Federal securities cases simply do not do so. *O'Hara v. Derschug*, 241 App. Div. 513, 272 N.Y.S. 189 (1934), was a common law fraud case and, rather than supporting the court's decision, supports petitioners' position.[7] *Cant v. A. G. Becker & Co.*, 379 F.Supp. 972 (N.D.Ill. 1974), did not consider directly the doctrine of mitigation of damages. *Beecher v. Able*, CCH Fed. Sec. L. Rptr. ¶95,016 (S.D.N.Y. 1975), was a suit brought under Section 11(a) of the Securities Act of 1933, 15 U.S.C. §77k, which does not apply the out-of-pocket damages rule, and the court specifically restricted its opinion to the interpretation of that statute.

The review by this Court of the question of mitigation of damages in Federal securities cases presented by this case is of exceptional importance because of the inconsistency of the Court of Appeals' decision with those of the other Federal courts which have addressed the issue, the determinative nature of the question with respect to the numerous lawsuits brought under the Federal securities laws, and the erroneousness of the decision of the Court of Appeals.

Just last Term, this Court expressed concern about "the potential for nuisance or 'strike' suits in this type of litigation." *Blue Chip Stamps v. Manor Drug Stores*, — U.S. —, 95 S.Ct. 539 (1975). The Court of Appeals' opinion, if allowed to

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[7] Indeed, the court cited *Reno v. Bull*, 226 N.Y. 546, 552 (1919), as adopting the out-of-pocket measure of damages and stated that, under that rule, if the purchase price later rose, "plaintiff would have suffered no recoverable damage".

stand, will invite and spawn such additional spurious litigation. Moreover, under this decision, plaintiffs in Federal securities litigation are directed and encouraged to "speculate" at the "risk" and "expense" of defendants, which even the Eighth Circuit had previously condemned. See, *Myzel v. Fields*, supra.

II. The Court Should Grant a Writ of Certiorari Because the Court of Appeals' Decision on the "Date for Fixing Damages" Conflicts With the Decisions of Other Circuits and Is Erroneous. In Addition, This Question Was Not Properly Before the Court of Appeals, Was Unnecessary for the Court's Adjudication of the Issues Properly Before It, and Was Not Briefed and Argued by All of the Parties.

The district court held that plaintiff was not damaged as a result of the alleged fraud and that the uncontroverted evidence established that he had failed to mitigate his damages. No issue concerning the "date for fixing damages" was presented to or ruled upon by the district court. This irrelevant issue was gratuitously interjected into the case by the panel of the Court of Appeals in disregard of the rule that an appellate court will not, and should not, review what the lower court did not decide. E.g., *Walters v. City of St. Louis*, 347 U.S. 231, 233 (1954). Indeed, the panel itself stated, "The district court did not purport to rely on these damage rules in dismissing the action (App. 39). Nevertheless, the panel proceeded to judicially write new law *in vacuo* without the benefit of thorough briefing and exhaustive oral argument by the parties or careful consideration of the ramifications of its decision.

The panel of the Court of Appeals held in its original opinion that "public discovery of the fraud is *the* proper date at which to ascertain damages" (App. 21) and "the value of [plaintiff's] AIC stock, for purposes of computing damages, *must* be measured by the market price after the fraud had been discovered by

the general public . . ." (App. 23). In response to defendants' petition for rehearing, the panel modified that opinion to hold that the date of the public discovery of a fraud is *a* proper date on which to measure damages.

No other court has so held. This holding rejects the long-standing rule, based upon *Sigafus v. Porter*, 179 U.S. 116, 125 (1900), that damages under the securities acts are determined as of the date of purchase—i.e., the difference between the actual value of the stock on that date and the price paid by the defrauded plaintiff. This rule, as even noted by the Court of Appeals, has been acknowledged by the First Circuit (*Janigan v. Taylor*, 344 F.2d 781, 786 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965)); Fourth Circuit (*Occidental Life Ins. Co. v. Pat Ryan & Assoc., Inc.*, 496 F.2d 1255, 1264-65 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974)); Fifth Circiut (*Wolf v. Frank*, 477 F.2d 467, 478-79 (5th Cir.), *cert. denied*, 414 U.S. 975 (1973)); Seventh Circuit (*Kohler v. Kohler Co.*, 208 F. Supp. 808, 825 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963)); Ninth Circuit (*Sackett v. Beaman*, 399 F.2d 884, 891 (9th Cir. 1968)); Tenth Circuit (*Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962));[8] and even previously by the Eighth Circuit (*Myzel v. Fields*, 386 F.2d 718, 744-45 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968)). See also, *Gottlieb v. Sandia America Corp.*, 304 F. Supp. 980, 991 (E.D. Pa. 1969), *aff'd in part, rev'd in part on other grounds*, 452 F. 2d 510 (3rd Cir.), *cert. denied*, 404 U.S. 938 (1971); *Sarlie v. E. L. Bruce Co.*, 265 F. Supp. 371, 375-6 (S.D.N.Y. 1967). See generally, 6 L. Loss, *Securities Regulation* 3922-23 (Supp. 1969); 3 Bromberg, *Securities Law*: Fraud 9.1 at 226 (1974).

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[8] A variation of this rule in two Tenth Circuit cases is the adoption of the date of discovery of the fraud by the purchaser as the date for measuring damages. *Richardson v. MacArthur*, 451 F.2d 35, 43-44 (10th Cir. 1971); *Esplin v. Hirschi*, 402 F.2d 94, 104 (10th Cir. 1968).

The panel's *sua sponte* departure from the holdings of other Circuits and the district courts is also illogical and almost impossible to implement. As only one example, the panel justified its original conclusion by stating "[i]t is only then [i.e., after public discovery] that the market can reflect the true value of the stock, unaffected by what is alleged to have been defendants' continuing fraud" (App. 21).[9] This rationale simply ignores the realities of the open market. It is far from the sterile laboratory which the panel's opinion presupposes. The value of stock is affected daily by innumerable factors other than alleged "continuing fraud."

Moreover, the panel's opinion would frequently permit a plaintiff to collect more damages than he could under the traditional application of the out-of-pocket rule.

In adopting a new rule *sua sponte* with respect to the date upon which damages are to be fixed in Federal securities litigation, the Court of Appeals has rendered a decision in conflict with those of all of the other Circuits which have addressed the issue. This unprecedented rule is illogical and impractical to apply and will impose additional burden and confusion upon courts confronted with the numerous complex cases brought under the securities acts. For these reasons, it is of national importance that the decision be reviewed by this Court.

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[9] The modified opinion only slightly watered down this statement: "The circumstances may disclose that only then did the market reflect the true value of the stock, unaffected by what is alleged to have been the defendants' continuing fraud" (App. 37).

CONCLUSION

For the reasons stated, it is respectfully submitted that this petition for Writ of Certiorari should be granted.

Respectfully submitted

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APPENDIX

APPENDIX A

Memorandum Opinion of District Court

Myron Harris, Plaintiff,

v.

American Investment Company et al., Defendants.

No. 71C 732 (A).

United States District Court,
E. D. Missouri, E. D.

June 24, 1974.

MEMORANDUM OPINION*

HARPER, District Judge.

All the defendants, American Investment Company (hereinafter referred to as AIC), Barnes, Hartley, Letourneau, Van Norman, Stuebner, Snow, Rand, McMillian, Kaufmann, Barber, Derrick, O'Brien and Burns (hereinafter referred to as individually appearing defendants) and Haskins & Sells, have moved to dismiss or strike Counts I and II of plaintiff's amended complaint with prejudice for failure to state a claim for which relief can be granted and for failure to comply with this Court's Memorandum and Order (hereinafter referred to as Memorandum) entered in this case on December 29, 1972. AIC and the individual defendants have moved to dismiss or strike Count III of the amended complaint for the same reasons as stated for dismissal of Counts I and II. The individual defendants have also moved to dismiss or strike Count IV of the amended complaint for failure to state a claim and for failure to comply with

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* Reported at 378 F.Supp. 894.

this Court's Memorandum. Counts I, II and III are challenged in the motions to dismiss or strike with prejudice for the same reasons. Accordingly, these motions to dismiss or strike with prejudice will be dealt with together.

AIC and the individually appearing defendants jointly filed a motion for summary judgment, and Haskins & Sells filed a motion for summary judgment on Counts I and II. The motion of AIC and the individually appearing defendants was supported by affidavit pursuant to Rule 56 of the F.R.Civ.P. As grounds for this motion the defendants contend that the pleadings and answers to interrogatories, together with the affidavit filed, show that the plaintiff has not suffered any damage as a result of any alleged wrongdoing of the defendants. AIC and the individually appearing defendants also jointly filed a motion to dismiss Counts I through III of the amended complaint as a class action. Plaintiff, Myron Harris, filed a motion for an order from this Court finding that this action is maintainable as a class action under Rule 23 of the F.R. C. P.

Plaintiff, a shareholder of AIC, brought this suit on his own behalf, as a representative of the class of all present and former common stockholders of AIC similarly situated, and derivatively on behalf of AIC against AIC, certain of its officers and directors, and Haskins & Sells, AIC's independent auditors. Plaintiff alleges that this Court has jurisdiction under Section 22 of the Securities Act of 1933, 15 U.S.C.A. § 77v, Section 27 of the Securities and Exchange Act of 1934, 15 U.S.C.A. § 78aa, and because of diversity of citizenship.

Count I of the amended complaint charges the defendants with violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j, and Rule 10(b)-5, 17 CFR 240.10b-5 (1949), promulgated pursuant thereto. Count I alleges that beginning on or before June 30, 1968, the defendants made, or caused to be made, misleading or false statements concerning the financial position and operating results of AIC or made such omissions of fact as to be misleading. Such statements or omissions were allegedly made in such places as press releases, statements and reports to stockholders, and reports and statements filed with the Securities and Exchange Commission and the New York Stock Exchange.

Count II of the amended complaint incorporates the allegations of Count I, and charges the defendants with a violation of Section 18(a) of the Securities Act of 1934, 15 U.S.C.A. § 78r, for filing reports and documents containing false and misleading statements or material omissions with the Securities and Exchange Commission.

Count III of the amended complaint charges that defendants, other than Haskins & Sells, violated Section 10(b) and Rule 10(b)-5 and Section A2 of AIC's listing agreement with the New York Stock Exchange by failing to advise AIC and its stockholders of favorable offers which had been made to the defendants for the stock of AIC in a proposed merger. Count III further alleges that these acts constitute fraud and deceit at common law.

Count IV of the amended complaint (a derivative action) alleges that the individual defendants who are or were officers or directors of AIC were guilty of breaching their fiduciary duty to the corporation and mismanaged and wasted the corporation's assets.

In this Court's Memorandum and Order dated December 29, 1972, this Court found that the allegations of Counts I, II and IV of the original complaint were too vague to withstand attack under F.R.C.P. 9(b), which requires that fraud be pleaded with particularity. Count I of the original complaint and Count II by incorporation by reference, alleged that "[B]eginning on or before June 30, 1968, and continuing through December 31, 1970, * * * defendants have caused to be circulated and dis-

seminated to the public numerous press releases * * * describing purported actual results of operations of AIC in such a way as to be misleading and misrepresentative." Count IV, by incorporating Count III by reference alleged that defendants failed to advise plaintiff "with respect to proposals by other publicly owned corporations, where AIC would merge, combine with, or be acquired."

The Court in granting defendants' motions at that time granted plaintiff leave to amend the complaint. Plaintiff filed an amended complaint which included in Counts I and II, thirty pages (pp. 7-36) of detailed references to the documents which contained the false and misleading statements and which identified the particular statement within each document misrepresented or omitted.

On page 5 of the Memorandum this Court quoted from Trussell v. United Underwriters, Ltd., 228 F.Supp. 757, 774 (D.Colo.1964) as follows:

> "The theory of Rule 9(b) is that the defendant in a case wherein the plaintiff alleges either fraud or mistake—unlike defendants in other actions—should be rather specifically apprised by the plaintiff's pleading of the occasion on which and the circumstances under which he allegedly defrauded a particular plaintiff. * * *
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> "Rule 9(b) does not, however, require the pleading of detailed evidentiary matter, nor does it require any particularity in connection with an averment of intent, knowledge, or condition of mind. It only requires identification of the circumstances constituting fraud or mistake."

Plaintiff's obligation is to apprise the defendants of the occasion on which and the circumstances under which he, defendant, allegedly defrauded the plaintiff. With particularity, plaintiff has apprised defendants of the occasions on which plaintiff alleged he was defrauded. The information respecting

fraud or mistake is set forth with sufficient clarity for the defendants to know what they are required to meet—no more, no less. Thus, the requirements of Rule 9(b) have been met in connection with Counts I and II. The motions to dismiss Counts I and II for failure to state a claim are overruled.

Count III of the amended complaint is the same as Count IV of the original complaint except for the allegation that jurisdiction is based upon the doctrine of pendent jurisdiction and the addition of the names of two publicly owned corporations with whom plaintiff alleges defendants had merger negotiations. The mere addition of two names in Count III of the amended complaint does not fulfill the demands of Rule 9(b). The defendants are neither apprised of the occasion on which or the circumstances under which they allegedly defrauded the plaintiff, as required by Trussell v. United Underwriters, Ltd., supra.

All of the defendants, except Haskins & Sells, move this Court to dismiss Count III for the additional reason that plaintiff failed to state a claim upon which relief can be granted because he failed to plead that he was a shareholder at the time of the acts complained of in Count III, and hence, could not have suffered any damage as a result thereof, as required in order to state a claim under Rule 10(b)-5. Smith v. Murchison, 310 F.Supp. 1709 [sic], 1084 (S.D.N.Y.1970). Count III alleges that the activity complained of, failure to disclose merger negotiations, commenced in 1968 and continued into 1969. Although plaintiff purchased his AIC stock on August 4, 1969, his pleadings do not state that he was a shareholder of AIC at the time of the alleged merger negotiations. Therefore, plaintiff could not have suffered any damage as the result of the acts complained of in Count III.

Count III of plaintiff's amended complaint also fails to state a claim for which relief can be granted under § 10(b) of the

Securities Exchange Act of 1934 for other reasons. As discussed in this Court's Memorandum and Order entered in this case on December 29, 1972, § 10(b)-Rule 10(b)-5 liability necessitates a showing that plaintiff either purchased or sold his stock in reliance on a violation of § 10(b)-Rule 10(b)-5. Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2nd Cir.) cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952).

At that time plaintiff requested leave to amend his complaint to allege purchase of his shares in reliance upon defendants' alleged misconduct of failing to disclose merger negotiations. Plaintiff has not amended his complaint to show such reliance and has failed to show that a loss flowed directly from his purchase of the AIC stock as required by Smith v. Murchison, supra, in order to state a claim under Rule 10(b)-5.

The plaintiff further alleges in Count III that another basis for seeking recovery in this count is alleged violations of Section A-2 of defendants' AIC's listing agreements with the New York Stock Exchange. In this Court's previous Memorandum and Order, it is stated on page 9: "* * * Violation of Section A2 of AIC's listing agreement with the New York Stock Exchange * * * rests upon diversity of citizenship," and invited the attention of the plaintiff to Snyder v. Harris, 394 U.S. 332, 89 S.Ct. 1053, 22 L.Ed.2d 319 (1969), and Zahn v. International Paper Company, 469 F. 2d 1033 (2nd Cir. 1972), affirmed 414 U.S. 291, 94 S.Ct. 505, 38 L.Ed.2d 511, with respect to plaintiff's amended pleadings.

By not complying with the requirements in these two cases the Court assumes the plaintiff cannot allege facts to support jurisdiction in a class action based on diversity with respect to Count III. The amended petition failed to comply with the Court's Memorandum. For the above reasons, the defendants' motions to dismiss for failure to state a cause of action are

sustained. Count III will accordingly be dismissed without prejudice.

The individually appearing defendants have moved the Court to dismiss or strike Count IV. These defendants contend that Count IV fails to comply with Rule 23.1 of the F.R.C.P. in that plaintiff failed to plead that he was a stockholder at the time of the alleged transactions of which he complains and failed to allege that he has requested the stockholder of AIC to take action, or his reason or excuse for not taking such action.

Turning first to the defendants' second contention that plaintiff failed to allege that he requested the stockholders of AIC to take action, the case of Heit v. Bixby, 276 F.Supp. 217 (E.D.Mo. 1967) is controlling. In the *Heit* case, the Court held that a stockholder's derivative action against all of the directors of a corporation for serious willful and negligent breaches of their fiduciary duties to the corporation should not be dismissed for plaintiff's failure to demand action on the part of the directors and stockholders of the corporation. In our present case Count IV is a stockholders' derivative action against all of the directors of AIC for breach of their fiduciary duties to the corporation. There is no merit to defendants' second contention.

With respect to the defendants' first contention, again it is evident from the pleadings that plaintiff failed to plead that he was a stockholder at the time of the events complained of in Count IV as required by Rule 23.1 of the F.R.C.P. In this Court's Memorandum, Count V of the original complaint was dismissed for failure to comply with Rule 23.1 of the F.R.C.P. There is no difference at all between Count IV of the amended complaint and Count V of the original complaint. The only item plaintiff added was a verification of the allegations in Count IV of the amended complaint. Plaintiff contends that a complaint is not to be dismissed on the grounds that the claims actually arose prior to the time plaintiff acquired his stock

where the complaint alleges continuing wrongdoing occurring at the time plaintiff owns stock. Bateson v. Magna Oil Corporation, 414 F.2d 128 (5th Cir. 1969), cert. denied 397 U.S. 911, 90 S.Ct. 909, 25 L.Ed.2d 91 (1970). This Court in Heit v. Bixby, supra, permitted recovery in a derivative action for wrongdoing which commenced before the date plaintiff acquired stock but continued after the date plaintiff acquired stock; however, the recovery was limited to the period the plaintiff was a stockholder. With respect to the allegations charged in Count IV, this Court in its previous Memorandum on page 8 set out the pertinent part of Rule 23.1 of the F.R.C.P. that applied to this count. In part, the rule says: "The complaint * * * shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains * * *." Plaintiff here simply has not pled when the wrongdoings complained of began nor does plaintiff allege that any of the wrongdoings continued after August 4, 1969, when he acquired AIC stock. The motion to dismiss for failure to state a cause of action as to Count IV is sustained.

In view of the Court's prior Memorandum and the failure of the plaintiff to set out the date of the alleged wrongdoing or that any of the alleged wrongdoings continued after he acquired his stock on August 4, 1969, the Court assumes the plaintiff cannot allege facts to support Count IV. For the above reasons the motion of the individually appearing defendants to dismiss for failure to state a cause of action is sustained. Count IV of the amended petition will accordingly be dismissed without prejudice.

The Court now takes up defendants' motion for summary judgment on Counts I and II. The undisputed facts relating to this motion for summary judgment on Counts I and II under Rule 56 of the F.R.C.P. are as follows: Plaintiff is presently the owner of one thousand (1,000) shares of AIC common stock which he purchased on August 4, 1969, at a price of $18⅞

per share. Since the date of purchase, the stock market price has fluctuated from a low of $7 to a high of $20. In the period from August 5, 1969, through May 31, 1971, AIC common stock sold on the open market at prices of $18⅞ or more for 47 days. This lawsuit was commenced on April 9, 1971, and for 18 of the first 30 days thereafter plaintiff could have sold his AIC stock at the price he paid for it or at a profit (Exhibit B. Affidavit of Warren E. Van Norman).

The defendants' contention is that the undisputed facts in this case disclose that plaintiff has not suffered any damages as a result of any alleged wrongdoing of the defendants because subsequent to plaintiff's purchase of his AIC common stock and subsequent to the filing of this lawsuit, plaintiff could have recouped his investment or sold at a profit on the open market: therefore, entitling defendants to summary judgment in their favor on Counts I and II. With this contention the Court agrees.

The facts of this case fall within the holding in Morrow v. Schapiro, 334 F. Supp. 399 (E.D.Mo.1971). In *Morrow*, plaintiff alleged violations of Section 10(b) and Rule 10(b)-5 in connection with the purchase and retention of stock of Permaneer Corporation. The Court sustained defendant's motion to dismiss for failure to state a claim upon which relief could be granted.

The complaint alleged that plaintiff had acquired 18,650 shares of Permaneer Corporation on the open market; that he was induced to purchase and retain the stock by misrepresentation made by defendants; that he paid $582,620 for his stock; that he subsequently could have sold the shares for approximately $700,000; that he was still the owner of the stock; and that the stock had a value of only $56,000.

The Court ruled that plaintiff failed to state a claim as a purchaser for the reason that subsequent to the purchase of the

stock he could have sold it at a profit, and hence, suffered no damages. On page 401 of the opinion the Court stated:

> "But as [the] defendants correctly observe[d], the complaint on its face shows that the investment was, at least initially, a profitable one. The stock increased in value from an original cost of $582,620 to $700,000. Even assuming that the misrepresentations were made and that plaintiff relied upon them in connection with the purchase of the securities, no damage can be shown as a result of such purchases."

In order to state a claim under Rule 10(b)-5 it must appear not only that a purchase or sale took place, but that there was a loss and that the loss flowed directly from the purchase or sale. Smith v. Murchison, supra. Plaintiff's loss, if any, did not flow directly from the purchase or sale of the AIC stock, but flowed from plaintiff's own investment decision to retain the AIC stock.

Even in cases of alleged fraud, a plaintiff has a duty to mitigate his damages upon discovery of the fraud. Lack Industries, Inc. v. Ralston Purina Co., 327 F.2d 266 (8th Cir. 1964); Transport Manufacturing & Equipment Company v. Fruehauf Trailer Co., 295 F.2d 223 (8th Cir. 1961). Plaintiff in our present cause had eighteen opportunities to sell his stock at the price he paid for it or at a profit within the first month after he filed suit. The only reason plaintiff gives for not selling his AIC stock is that if he had done so he would have lost his standing to pursue a derivative action on behalf of the AIC. This was a personal decision and not the result of any alleged fraud on the part of any of the defendants.

Plaintiff argues that Travis v. Anthes Imperial Ltd., 473 F.2d 515 (8th Cir. 1973) implicitly limits the holding of the Morrow v. Schapiro, supra, very narrowly. In the *Travis* case the defendants through misrepresentation and fraud caused plaintiffs to

believe that they would later receive a tax-free exchange or an equivalent offer for their stock after a tender offer to Canadian shareholders had expired and that they, therefore, should hold onto their Anthes stock. The Eighth Circuit Court of Appeals in its opinion in the *Travis* case, at page 521, said:

> "Absent defendants' encouragement, the plaintiffs would have sold their stock earlier when a market for Anthes stock existed and the price was higher. The fact that the sale took place at a time when the plaintiffs were aware of all the facts, including defendants' misrepresentations, is not fatal to the plaintiffs' claim."

The *Morrow* and *Travis* cases are distinguishable on very basic and sound grounds. In *Travis* there was a sale of the stock involved after the fraud was discovered and the sale was at a loss. In *Morrow*, as in our present cause, there was no sale of the stock. There is an additional fact that distinguishes our present case from both *Morrow* and *Travis*. Unlike the plaintiffs in *Morrow* and *Travis*, the plaintiff in our present cause could have sold his stock without suffering a loss after he discovered the alleged fraud.

The courts have repeatedly held that one who retains his stock cannot bring himself under the provisions of § 10(b); he must be a defrauded "seller" to qualify. Greenstein v. Paul, 400 F.2d 580 (2nd Cir. 1968); Herpich v. Wallace, 430 F.2d 792 (5th Cir. 1970); Cooper v. Garza, 431 F.2d 578 (5th Cir. 1970).

Plaintiff's loss was not in connection with the purchase of his AIC stock because he had numerous opportunities to sell without a loss after he discovered the alleged fraud, and plaintiff's loss was not in connection with the sale of his AIC stock because of his investment decision to retain the stock. Therefore, defendants are entitled to summary judgment in their favor on Counts I and II.

For the above stated reasons this Court sustains the motion of AIC and the individually appearing defendants for summary judgment on Counts I and II in their favor and against the plaintiff.

Turning now to the motion of AIC and the individually appearing defendants to dismiss Counts I through III of the amended complaint as a class action, it is fundamental that the class representative must himself possess a cause of action. Kansas City, Missouri v. Williams, 205 F.2d 47, 51 (8th Cir.), cert. denied 346 U.S. 826, 74 S.Ct. 45, 98 L.Ed. 351; Kauffman v. Dreyfus Fund, Inc., 2 Cir., 434 F.2d 727, 734. In view of the Court's ruling with respect to Counts I, II and III, the motion of AIC and the individually appearing defendants to dismiss will be sustained. This ruling also disposes of the defendants' motion with respect to declaring this a class action.

The Clerk of the Court will prepare and enter the proper order carrying out the Court's rulings as follows: Overruling the motions of all defendants to dismiss or strike as to Counts I and II of plaintiff's amended complaint for failure to state a claim for which relief can be granted; sustaining the motion of AIC and the individually appearing defendants to dismiss or strike Count III of plaintiff's amended complaint for failure to state a claim for which relief can be granted; sustaining the motion of the individually appearing defendants to dismiss or strike Count IV of plaintiff's amended complaint for failure to state a claim for which relief can be granted and dismissing Counts III and IV of plaintiff's amended complaint without prejudice; sustaining the motion of all defendants for summary judgment as to Counts I and II of plaintiff's amended complaint; and sustaining the motion of AIC and the individually appearing defendants to dismiss Counts I, II and III of the amended complaint as a class action.

APPENDIX B

Original Opinion of Court of Appeals

United States Court of Appeals
for the Eighth Circuit

No. 74-1573

Myron Harris, Appellant, v. American Investment Company, et al., Appellees.	Appeal from the United States District Court for the Eastern District of Missouri.

Submitted: February 14, 1975

Filed: June 18, 1975

Before Matthes, Senior Circuit Judge; Bright and Stephenson, Circuit Judges.

Bright, Circuit Judge.

Myron Harris, who holds 1,000 shares of common stock of American Investment Company (AIC) which he purchased on August 4, 1969, through a public stock exchange, brings this action individually and on behalf of the class of all AIC shareholders similarly situated. He names as defendants AIC, certain of its officers and directors, and the accounting firm of Haskins & Sells, and he alleges the following wrongdoing:

a) Counts I and II (against all defendants): Immediately before and continuing after 1969 the defendants published false and misleading statements in violation of § 10(b) of **[2]*** the

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* Numbers in boldface in brackets indicate pages of the slip opinion.

Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 (1974), and filed false and misleading information with the Securities and Exchange Commission in violation of § 18(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78r(a) (1970).[1]

[3] b) Count III (against defendants other than AIC and **[4]** Haskins & Sells): The individual defendants violated § 10(b) of the Securities Exchange Act, Rule 10b-5, and AIC's listing agreement with the New York Stock Exchange and committed fraud upon AIC shareholders by failing to inform AIC and its shareholders of merger proposals from other corporations.

c) Count IV (stockholder derivative action): The individual defendants mismanaged AIC.

On motion of the defendants, the district court granted summary judgment dismissing Harris' individual claim for damages under counts I and II. Then, because Harris no longer possessed a cause of action himself, the district court also dismissed the class action in these counts.

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[1] Harris alleges that these misrepresentations and omissions induced him and others to buy and retain AIC stock and caused an artificially inflated market value for the stock.

Section 10(b) of the Securities Exchange Act provides as follows:

> Regulation of the use of manipulative and deceptive devices.—It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. [15 U.S.C. §78j(b) (1970).]

Rule 10b-5 provides as follows:

> Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. [17 C.F.R. § 240.10b-5 (1974).]

Section 18(a) of the Securities Exchange Act provides as follows:

> Liability for misleading statements.—(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder, or any undertaking contained in a registration statement as provided in subsection (d) of this section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. * * * [15 U.S.C. §78r(a) (1970).]

The district court also dismissed count III as an individual and class action for failure to state a claim, for Harris had failed to allege that he was a stockholder at the time of the incidents which formed the basis for the count.

The district court dismissed the derivative action, count IV, for failure to state a claim for which relief can be granted because it concluded that Harris had failed, as he had in count III, to allege that he was a stockholder at the time of the incidents complained of. The court's dismissal of counts III and IV was without prejudice.[2]

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[2] The district court opinion is reported at 378 F. Supp. 894 (E.D. Mo. 1974).

Harris appeals, contending that the trial court erred in granting summary judgment on his individual claims in counts [5] I and II; in dismissing the class allegations in those counts; and in dismissing the derivative action alleged in count IV. He raises no question on appeal with respect to the dismissal of count III. We find it necessary to resolve the merits only with respect to Harris' individual claims in counts I and II. We reverse and remand the cause for further proceedings in the district court.

Since this case comes before us after summary disposition, the record is skeletal at best, limited to the facts alleged in the pleadings and the facts appearing in defendants' affidavit in support of their motion for summary judgment. Nonetheless, we are able to reconstruct a factual background adequate for purposes of discussion.

AIC stock is publicly traded on the New York Stock Exchange. Harris purchased his shares on August 4, 1969, at a price of \$18⅞. The market for this stock remained fairly constant for a time, but by June 30, 1970, the stock had plunged to \$7½. It recovered somewhat thereafter, and by April 8, 1971, the day preceding the filing of the complaint, AIC shares were sold on the New York Stock Exchange at a high of \$16⅝ and a low of \$16⅛.

Harris contends that in the fall of 1970 he came to believe that he had been the victim of an on-going scheme of misrepresentation and fraudulent concealment of information. At that time the market price of AIC stock had fallen to approximately \$9 per share. He contends that he approached his attorneys at that time to discuss possible federal securities law violations. The attorneys prepared a complaint in the winter of 1970 and, as we have noted, filed it in early April of 1971.

[6] I. Damages.

The dispute in this case focuses upon whether the appellant individually sustained any recoverable damages from the defendants' alleged violations of §§ 10(b) and 18(a) of the Securities Exchange Act. In granting summary judgment, the district court ruled that Harris has suffered no damages. The court reasoned as follows:

> The defendants' contention is that the undisputed facts in this case disclose that plaintiff has not suffered any damages as a result of any alleged wrongdoing of the defendants because subsequent to plaintiff's purchase of his AIC common stock and subsequent to the filing of this lawsuit, plaintiff could have recouped his investment or sold at a profit on the open market: therefore, entitling defendants to summary judgment in their favor on Counts I and II. With this contention the Court agrees. [378 F. Supp. at 900.]

The district court noted that following Harris' purchase of the stock its price exceeded \$18⅞—his purchase price—for 47 days through May 31, 1971. Included in this period were 18 days out of the 30 days immediately subsequent to the commencement of this action. However, the record shows that between the fall of 1970, when plaintiff asserts that he first suspected fraud, and the filing of the lawsuit, the stock at no time equaled or exceeded the purchase price.

The validity of the district court's holding rests upon its legal determination that the defendants may be absolved from liability by showing that the plaintiff could have recouped his loss by selling his stock subsequent to his discovery of their alleged fraud, including sale after [7] the institution of the lawsuit. We disagree with this determination. We hold that on the record presented in this case it cannot be concluded, for purposes of summary judgment, that plaintiff has suffered no damages.

A. **Date for fixing damages.**

Although the federal securities laws in several instances offer greater protection to buyers and sellers of securities than do common law fraud concepts, *see* 3 L. Loss, *Securities Regulation* 1435-36 (2d ed. 1961), common law fraud concepts underlie the securities laws and provide guidance as to their reach and application, particularly where, as here, Congress has not specified the remedies available to a defrauded buyer.[3]

In cases arising under §10(b) and Rule 10b-5 the federal courts employ an out-of-pocket rule of damages borrowed from the tort action of deceit.[4] *See Madigan, Inc. v. Goodman,* **[8]** 498 F.2d 233, 239 (7th Cir. 1974); *Wolf v. Frank,* 477 F.2d 467, 478-79 (5th Cir.), *cert. denied,* 414 U.S. 975 (1973); *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 303 F.2d 527, 533 (10th Cir. 1962); *see generally* 6 L. Loss, *Securities Regulation* 3922-23 (Supp. 1969); Note, *Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities,* 26 Stan. L.Rev. 371,

[3] Although Congress in §18(a) has expressly authorized recovery of damages resulting from false or misleading statements in filed documents, it did not specify how and when the damages are to be measured. *Compare* §11(e) of the Securities Act of 1933, 15 U.S.C. §77k(e) (1970) (civil liabilities on account of false registration statement). Thus, to the extent that §18(a) is silent with respect to the measurement of damages we view it in the same light as we view §10(b), which is silent with respect to remedies altogether. Unless otherwise indicated, our discussion therefore applies equally to §§10(b) and 18(a).

[4] One commentator has described this rule in the following terms:

> [The out-of-pocket rule] allows recovery of the difference between the actual value of what the injured party gave and what he received. In contrast with restitution damages, the plaintiff recovers what he has lost, rather than what the defendant has gained. The injured investor is given nothing for the loss of the benefit that he would have enjoyed had defendant's representations been true. [Note, *Measurement of Damages in Private Actions under Rule 10b-5,* 1968 Wash. U.L.Q. 165, 172.]

See also W. Prosser, *Law of Torts* §110 at 733-34 (4th ed. 1971).

383-85 (1974). *But see Ohio Drill & Tool Company v. Johnson,* 498 F.2d 186, 190-91 (6th Cir. 1974) (proper measure of damages is disgorgement of profits by defrauding seller); *Zeller v. Bogue Electric Manufacturing Corp.,* 476 F.2d 795, 801-03 (2d Cir.), *cert. denied,* 414 U.S. 908 (1973) (same).

The *Restatement of Torts* (1938), at § 549, measures damages under this rule as

> (a) the difference between the value of the thing bought, sold or exchanged and its purchase price or the value of the thing exchanged for it * * *.

Thus, actual pecuniary loss rather than loss of bargain is the measure of damages:

> Under the [out-of-pocket] rule stated in * * * Clause [(a)] the recipient of a fraudulent misrepresentation is entitled to recover from its maker only the actual loss which be- **[9]** cause of its falsity he sustains by his action or inaction in reliance upon it. If notwithstanding the falsity of the representation the thing which a vendee acquires is of equal or greater value than the price paid and he has suffered no harm through using it in reliance upon its being as represented, he has suffered no loss and can recover nothing. [*Restatement of Torts* § 549, comment b at 110.]

The federal courts have identified two dates at which damages under the out-of-pocket rule may be ascertained. Quoting from *Sigafus v. Porter,* 179 U.S. 116, 125 (1900), Judge Aldrich of the First Circuit has suggested that damages for a defrauded purchaser of securities coming within the coverage of § 10(b) and Rule 10b-5 should be fixed as of the date of purchase:

> [T]he damages are to be reckoned solely by "the difference between the real value of the property at the date

of its sale to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to the defendant's conduct, but not damages covering 'the expected fruits of an unrealized speculation' [*Smith v. Bolles,* 132 U.S. 125, 130 (1889)]." [*Janigan v. Taylor,* 344 F.2d 781, 786 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965).]

Accord, Occidental Life Insurance Co. v. Pat Ryan & Associates, 496 F.2d 1255, 1264-65 (4th Cir.) (*semble*), *cert. denied,* 419 U.S. 1023 (1974); *Wolf v. Frank, supra,* 477 F.2d at 478-79; *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra,* 303 F.2d at 533 (dictum); *Gottlieb v. Sandia American Corp.,* 304 F. Supp. 980, 991 (E.D. Pa. 1969), *aff'd in part, rev'd in part on other grounds,* 452 **[10]** F.2d 510 (3d Cir.), *cert. denied,* 404 U.S. 938 (1971). The typical fact situation in these cases discloses an alleged fraudulent concealment or misrepresentation by a seller directed at the buyer-plaintiff only and not the public at large. Hence, the actual worth of the securities at the time of purchase by the plaintiff is readily ascertainable. *But see Gottlieb v. Sandia American Corp., supra,* 304 F. Supp. at 989-90.

The *Restatement of Torts* observes that there may be difficulty ascertaining the value of the article transferred in connection with a misrepresentation where the misrepresentation affects the market price of the article. This is particularly true with respect to publicly-traded securities:

> The value of the article is normally determined by the price at which it could be resold in an open market or by private sale if its quality or other characteristics which affect its value were known. However, the price which determines the value of the article is not necessarily the price which it would bring at the time the sale is made.

> In many cases this price is due to the widespread belief of other buyers in misrepresentations similar to that made to the person seeking recovery, as where the market price of securities, such as bonds or shares, is the result of widely spread misrepresentations of those who issue or market them. The fact that the market price is inflated or depressed by such misrepresentations is the important factor which makes the price fictitious * * *. [*Restatement of Torts* § 549, comment c at 111.]

Thus, where a defendant's fraudulent conduct is alleged, **[11]** as it is in this case, to have caused an artificial market of long duration, damages have been fixed, consistently with the *Restatement's* position, not at the date of purchase but rather at the date of discovery of the fraud. *See Esplin v. Hirschi,* 402 F.2d 94, 104-05 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969); *see also Chasins v. Smith, Barney & Co.,* 306 F. Supp. 177, 178 (S.D. N.Y. 1969) (failure by broker to disclose his position as a market-maker).

Although the Tenth Circuit has fixed damages as of the date that the buyer actually discovered, or should have discovered, the seller's fraud, *Richardson v. MacArthur,* 451 F.2d 35, 43-44 (10th Cir. 1971); *Esplin v. Hirschi, supra,* 402 F.2d at 104, we believe that in the instant case the public discovery of the fraud is the proper date at which to ascertain damages. It is only then that the market can reflect the true value of the stock, unaffected by what is alleged to have been the defendants' continuing fraud:

> [V]alue is determined by their [*i.e.,* the securities'] market price after the fraud is discovered when the price ceases to be fictitious and represents the consensus of buying and selling opinion of the value of the securities as they actually are.
>
> * * *

In the majority of stock transactions the person seeking recovery discovers the falsity of the misrepresentations at the same time that it becomes known to the investing public and, therefore, at a time when the price of the stock is no longer inflated or depressed by the same or similar misrepresentations. It may be, however, that he discovers the falsity of the representations either earlier or later than the general public. In the first situation, his loss is determined by the actual value of the securities in question shown by their **[12]** market price after the public discovery of the fraud brings the price into accord with the actual value. In the second situation, where the person seeking recovery does not learn of the falsity of the facts represented until sometime after the general public has discovered it, the value of the securities is fixed by the price at which they are selling at the time of his and not of the public's discovery. [*Restatement of Torts* § 549, comment c at 111, 112-13.][5]

The American Law Institute's *Federal Securities Code* draft adopts in principle this same reasoning:

The measure of damages * * * is

(A) if the plaintiff is a buyer, the difference between the amount that he paid and the value of the security determined as of the time specified in section 1402 (e)(1) [*i.e.*, when, *inter alia*, all material facts became generally available to the investing public.] [ALI, *Federal Securities Code* § 1402(f)(1)(A) (Tent. Draft No. 2, 1973).]

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[5] The *Restatement (Second) of Torts* retains this formulation of the date for fixing damages. *Id.* §549, comment c at 30-32 (Tent. Draft No. 11, 1965).

This proposed codification incorporates the common law rule for the date of ascertaining damages. ALI, *Federal Securities Code* § 1402(f)(1), comments (1)(b), (4)(b), (5)(b).[6]

[13] Thus, the value of Harris' AIC stock, for purposes of computing damages, must be measured by the market price after the fraud had been discovered by the general public, *i.e.*, when all material facts had become known to the public such that the market price had ceased to be fictitious. Since the record does not address itself to when public discovery occurred, the district court erred in granting summary judgment for the defendants. It may very well be that the plaintiff ferreted out the defendants' alleged fraud prior to its discovery by the general public and that public discovery, consequently, coincided with or immediately followed the institution of the lawsuit. In such an event plaintiff would have sustained little or no compensable injury. The proof may show, however, that public discovery preceded the suit, when the market value of the stock was much lower. In such an event plaintiff's damages could prove substantial. These matters are for the trial court to determine on remand.

B. **Mitigation of damages.**

A defrauded buyer of securities may maintain an action for damages under § 10b, and, presumably, § 18(a), even though he continues to hold the securities. *Pfeffer v. Cressaty*, 223 F. Supp. 756, 758 (S.D. N.Y. 1963); *see Occidental Life Insur-*

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[6] The appellees urge that *Morrow v. Schapiro*, 334 F.Supp. 399 (E.D. Mo. 1971), calls for the conclusion that the plaintiff in this case has suffered no compensable injury. We do not read *Morrow* to reach the issue presented here. In *Morrow*, the court assumed that the market value of the plaintiff's securities, which was greater than the purchase price, reflected—contrary to market value in the instant case—nothing other than the actual value of the securities and it reasoned that the plaintiff had therefore sustained no loss by misrepresentations that might have induced his purchase. *Id.* at 401.

ance Co. v. Pat Ryan & Associates, supra, 496 F.2d at 1264-65; *Wolf v. Frank, supra,* 477 F.2d at 478; *Sackett v. Beaman,* 399 F.2d 884, 891 (9th Cir. 1968); *Johns Hopkins University v. Hutton,* 326 F. Supp. 250, 262 **[14]** (D. Md. 1971), *aff'd in part, rev'd in part on other grounds,* 488 F.2d 912 (4th Cir. 1973), *cert. denied,* 416 U.S. 916 (1974). At common law, a defrauded purchaser of securities is under no duty to sell them prior to maintaining an action for deceit but may hold them for investment purposes if he chooses. *See Hindman v. First National Bank,* 112 F. 931, 935-36 (6th Cir.), *cert. denied,* 186 U.S. 483 (1902); *Hotaling v. A. B. Leach & Co.,* 247 N.Y. 84, 159 N.E. 870, 872 (1928); *Stephens v. Wheeler,* 193 Wis. 164, 213 N.W. 464, 468 (1927). Thus, Harris was under no duty to sell his AIC stock, for mitigation of damages or any other purpose, prior to commencing this action.

Where one has bought securities for long-term investment, it would be inappropriate to apply a rule requiring him to sell them prematurely for the benefit of the defrauding defendant. Inasmuch as we have held that Harris' damages are to be measured as of the date of public discovery of the fraud,

> [t]he plaintiff will not be able to avail himself of any further decrease in the value of the security after that date. So also the defendant should not be able to avail itself of any increase in the value of the stock after that date. This is the only method in which a consistent measure of damages can be obtained. [*Cant v. Becker & Co.,* 379 F. Supp. 972, 975 (N.D. Ill. 1974).]

Accord, O'Hara v. Derschug, 241 App. Div. 513, 272 N.Y.S. 189, 198 (1934). *See also Beecher v. Able,* No. 66 Civ. 3471, CCH Fed. Sec. L. Rep. ¶95,016 at 97,561 (S.D. N.Y. Mar 17, 1975) (no need for plaintiff to mitigate damages in action under Section 11(a) of the Securities Act of 1933, 15 U.S.C. §77k(a) (1970), by selling stock after statutory date for measurement of damages).

[15] Consequently, we reject the appellees' contention that Harris was under a duty, after discovery of the fraud, to sell his AIC stock for the benefit of the appellees. By continuing to hold the stock after that date Harris has, in effect, made a second investment decision unrelated to his initial decision to purchase the stock. As the court observed in *Cant v. Becker & Co., supra,* 379 F. Supp. at 975, what happens after this second decision has no bearing whatsoever on the measure of plaintiff's damages.

II. Other Issues

Harris requests that, if we should reverse the district court's ruling on damages, we should also certify counts I and II as a class action. He contends that he is entitled as a matter of law to bring this case as a class action. We decline the invitation to decide at this juncture of the case whether it should proceed as a class action.

The district court dismissed the class action with respect to counts I and II because it had determined that Harris could recover no damages on his individual claims under these counts and therefore could not adequately represent all defrauded purchasers of AIC stock. Until the district court can reconsider Harris' adequacy as a representative of a proper class, we deem it inappropriate to evaluate the propriety of a class action. Accordingly, the appeal on this issue is dismissed.

Harris also seeks our review of the district court's order dismissing without prejudice the allegations contained in count IV, a derivative action. As we have noted, this dismissal rested upon the failure of the appellant to plead specifically, as required by Fed. R. Civ. P. 23.1(1), that he **[16]** was a stockholder at the time of the commission of the alleged wrongs by the directors and officers of the corporation.

According to Harris' contention, he has discussed certain of the events referred to in count IV in detail in other counts of

his complaint. He contends that by reference to these allegations in other counts, count IV should be construed as alleging that he held stock at the time that defendants were guilty of misconduct in managing AIC.

We do not reach the merits of this contention. The district court dismissed count IV without prejudice. Such a dismissal does not constitute an appealable final order under 28 U.S.C. §1291 (1970). *See, e.g., Azar v. Conley,* 480 F.2d 220, 223 (6th Cir. 1973) (dismissal of complaint without prejudice); *American Broadcasting Co. v. Wahl Co.,* 121 F.2d 412, 413 (2d Cir. 1941) (dismissal of count of complaint with leave to amend); *cf. Olson v. Rembrandt Printing Co.,* 511 F.2d 1228, 1230-31 (8th Cir. 1975); *Piel v. Harvard Interiors Manufacturing Co.,* 490 F.2d 1272 (8th Cir. 1974). If these wrongs in fact occurred after Harris acquired his stock, it would be proper on remand for Harris to seek leave to amend his complaint to bring count IV squarely within the prescription of Rule 23.1(1).

III. **Summary.**

In summary, we reach no issue on this appeal other than that of damages. We reverse the grant of summary judgment on Harris' individual claims under counts I and II. Lest our opinion be misunderstood, we do not hold that plaintiff has made out a case entitling him to damages if he is able **[17]** to prove fraudulent misrepresentations or omissions by the defendants.[7]

[7] In order to recover any damages Harris must, on remand, prove all the elements for recovery under §10(b) and Rule 10b-5, *see, e.g., Myzel v. Fields,* 386 F.2d 718, 733-37 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968), or §18(a), *see Heit v. Weitzen,* 402 F.2d 909, 914-16 (2d Cir. 1968), *cert. denied,* 395 U.S. 903 (1969). Among these elements is reliance by Harris upon the defendants' omissions and misrepresentations, more accurately characterized as causation in fact. *E.g., Clegg v. Conk,* 507 F.2d 1351, 1361 n.14 (10th Cir. 1974), *petition for cert. filed,* 43 U.S.L.W. 3531 (U.S. Mar. 4, 1975) (No. 74-1096). *See also Affiliated Ute Citizens v. United States,* 406 U.S. 128, 153-54 (1972); *Schlick v. Penn-Dixie Cement Corp.,* 507 F.2d 374, 380-81 (2d Cir. 1974); *Globus v. Law Research Service, Inc.,* 418 F.2d 1276, 1291-92 (2d Cir. 1969), *cert. denied,* 397 U.S. 913 (1970); *Werfel v. Kramarsky,* 61 F.R.D. 674, 681 (S.D. N.Y. 1974); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 353 F. Supp. 264, 274-79 (S.D. N.Y. 1972), *aff'd,* 495 F.2d 228, 238-41 (2d Cir. 1974). *See generally* Note, *Reliance Requirement in Private Actions under SEC Rule 10b-5,* 88 Harv. L. Rev. 584, 587-96 (1975).

We hold only that on the record before us it cannot be said as a matter of law that Harris cannot collect damages even if he should establish the existence of the alleged fraudulent misrepresentations and omissions.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit.

APPENDIX C

Order on Petitions for Rehearing

United States Court of Appeals for the Eighth Circuit

No. 74-1573

Myron Harris, Appellant, vs. American Investment Company, et al., Appellees.	Appeal from the United States District Court for the Eastern District of Missouri.

Order

In response to the appellees' petitions for rehearing or for rehearing en banc, the opinion of June 18, 1975, is modified as follows:

> Pages 7 through 17 are withdrawn and replaced by new pages 7 through 17 attached hereto and by reference made a part of this order.

In all other respects the petitions for rehearing or for rehearing en banc are denied.

Dated this 11th day of August 1975.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, 8th Circuit.

APPENDIX D

Modified Opinion of Court of Appeals

United States Court of Appeals
for the Eighth Circuit

No. 74-1573

Myron Harris, Appellant, v. American Investment Company, et al., Appellees.	Appeal from the United States District Court for the Eastern District of Missouri.

Submitted: February 14, 1975

Filed: June 18, 1975

Modified: August 11, 1975

Before Matthes, Senior Circuit Judge; Bright and Stephenson, Circuit Judges.

Bright, Circuit Judge.

Myron Harris, who holds 1,000 shares of common stock of American Investment Company (AIC) which he purchased on August 4, 1969, through a public stock exchange, brings this action individually and on behalf of the class of all AIC shareholders similarly situated. He names as defendants AIC, certain of its officers and directors, and the accounting firm of Haskins & Sells, and he alleges the following wrongdoing:

a) Counts I and II (against all defendants); Immediately before and continuing after 1969 the defendants published false and misleading statements in violation of § 10(b) of **[2]*** the

* Numbers in boldface in brackets indicate pages of the slip opinion.

Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 (1974), and filed false and misleading information with the Securities and Exchange Commission in violation of § 18(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78r(a) (1970).[1]

[3] b) Count III (against defendants other than AIC and **[4]** Haskins & Sells): The individual defendants violated § 10(b) of the Securities Exchange Act, Rule 10b-5, and AIC's listing agreement with the New York Stock Exchange and committed fraud upon AIC shareholders by failing to inform AIC and its shareholders of merger proposals from other corporations.

c) Count IV (stockholder derivative action): The individual defendants mismanaged AIC.

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[1] Harris alleges that these misrepresentations and omissions induced him and others to buy and retain AIC stock and caused an artificially inflated market value for the stock.

Section 10(b) of the Securities Exchange Act provides as follows:

> Regulation of the use of manipulative and deceptive devices.—It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. [15 U.S.C. § 78j(b) (1970).]

Rule 10b-5 provides as follows:

> Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. [17 C.F.R. § 240.10b-5 (1974)].

Section 18(a) of the Securities Exchange Act provides as follows:

> Liability for misleading statements.—(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder, or any undertaking contained in a registration statement as provided in subsection (d) of this section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. * * * [15 U.S.C. § 78r(a) (1970).]

On motion of the defendants, the district court granted summary judgment dismissing Harris' individual claim for damages under counts I and II. Then, because Harris no longer possessed a cause of action himself, the district court also dismissed the class action in these counts.

The district court also dismissed count III as an individual and class action for failure to state a claim, for Harris had failed to allege that he was a stockholder at the time of the incidents which formed the basis for the count.

The district court dismissed the derivative action, count IV, for failure to state a claim for which relief can be granted because it concluded that Harris had failed, as he had in count III, to allege that he was a stockholder at the time of the in-

cidents complained of. The court's dismissal of counts III and IV was without prejudice.[2]

Harris appeals, contending that the trial court erred in granting summary judgment on his individual claims in counts [5] I and II; in dismissing the class allegations in those counts; and in dismissing the derivative action alleged in count IV. He raises no question on appeal with respect to the dismissal of count III. We find it necessary to resolve the merits only with respect to Harris' individual claims in counts I and II. We reverse and remand the cause for further proceedings in the district court.

Since this case comes before us after summary disposition, the record is skeletal at best, limited to the facts alleged in the pleadings and the facts appearing in defendants' affidavit in support of their motion for summary judgment. Nonetheless, we are able to reconstruct a factual background adequate for purposes of discussion.

AIC stock is publicly traded on the New York Stock Exchange. Harris purchased his shares on August 4, 1969, at a price of \$18⅞. The market for this stock remained fairly constant for a time, but by June 30, 1970, the stock had plunged to \$7½. It recovered somewhat thereafter, and by April 8, 1971, the day preceding the filing of the complaint, AIC shares were sold on the New York Stock Exchange at a high of \$16⅝ and a low of \$16⅛.

Harris contends that in the fall of 1970 he came to believe that he had been the victim of an on-going scheme of misrepresentation and fraudulent concealment of information. At that time the market price of AIC stock had fallen to approximately \$9 per share. He contends that he approached his attorneys at that time to discuss possible federal securities law violations. The attorneys prepared a complaint in the winter of 1970 and, as we have noted, filed it in early April of 1971.

[2] The district court opinion is reported at 378 F. Supp. 894 (E.D.Mo. 1974).

[6] I. **Damages.**

The dispute in this case focuses upon whether the appellant individually sustained any recoverable damages from the defendants' alleged violations of §§ 10(b) and 18(a) of the Securities Exchange Act. In granting summary judgment, the district court ruled that Harris has suffered no damages. The court reasoned as follows:

> The defendants' contention is that the undisputed facts in this case disclose that plaintiff has not suffered any damages as a result of any alleged wrongdoing of the defendants because subsequent to plaintiff's purchase of his AIC common stock and subsequent to the filing of this lawsuit, plaintiff could have recouped his investment or sold at a profit on the open market: therefore, entitling defendants to summary judgment in their favor on Counts I and II. With this contention the Court agrees. [378 F. Supp. at 900.]

The district court noted that following Harris' purchase of the stock its price exceeded \$18⅞—his purchase price—for 47 days through May 31, 1971. Included in this period were 18 days out of the 30 days immediately subsequent to the commencement of this action. However, the record shows that between the fall of 1970, when plaintiff asserts that he first suspected fraud, and the filing of the lawsuit, the stock at no time equaled or exceeded the purchase price.

The validity of the district court's holding rests upon its legal determination that the defendants may be absolved from liability by showing that the plaintiff could have recouped his loss by selling his stock subsequent to his discovery of their alleged fraud, including sale after [7] the institution of the law-

suit. We disagree with this determination. We hold that on the record presented in this case it cannot be concluded, for purposes of summary judgment, that plaintiff has suffered no damages.

A. *Possible dates for fixing damages.*

Although the federal securities laws in several instances offer greater protection to buyers and sellers of securities than do common law fraud concepts, *see* 3 L. Loss, *Securities Regulation* 1435-36 (2d ed. 1961), common law fraud concepts underlie the securities laws and provide guidance as to their reach and application, particularly where, as here, Congress has not specified the remedies available to a defrauded buyer.[3]

In cases arising under §10(b) and Rule 10b-5 the federal courts employ an out-of-pocket rule of damages borrowed from the tort action of deceit.[4] *See Madigan, Inc. v. Goodman,* 498

[3] Although Congress in §18(a) has expressly authorized recovery of damages resulting from false or misleading statements in filed documents, it did not specify how and when the damages are to be measured. *Compare* §11(e) of the Securities Act of 1933, 15 U.S.C. §77k(e) (1970) (civil liabilities on account of false registration statement). Thus, to the extent that §18(a) is silent with respect to the measurement of damages we view it in the same light as we view §10(b), which is silent with respect to remedies altogether. Unless otherwise indicated, our discussion therefore applies equally to §§10(b) and 18(a).

[4] One commentator has described this rule in the following terms:

> [The out-of-pocket rule] allows recovery of the difference between the actual value of what the injured party gave and what he received. In contrast with restitution damages, the plaintiff recovers what he has lost, rather than what the defendant has gained. The injured investor is given nothing for the loss of the benefit that he would have enjoyed had defendant's representations been true. [Note, *Measurement of Damages in Private Actions under Rule 10b-5,* 1968 Wash.U.L.Q. 165, 172.]

See also W. Prosser, *Law of Torts* §110 at 733-34 (4th ed. 1971).

F.2d 233, 239 (7th Cir. 1974); *Wolf v. Frank,* 477 F.2d 467, 478-79 (5th Cir.), *cert. denied,* 414 U.S. 975 (1973); *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 303 F.2d 527, 533 (10th Cir. 1962); *see generally* 6 L. Loss, *Securities Regulation* 3922-23 (Supp. 1969); Note, *Measure of Damages in Rule 10b-5 Cases Involving Actively Traded Securities,* 26 Stan. L.Rev. 371, 383-85 (1974). *But see Ohio Drill & Tool Co. v. Johnson,* **[8]** 498 F.2d 186, 190-91 (6th Cir. 1974) (proper measure of damages is disgorgement of profits by defrauding seller); *Zeller v. Bogue Electric Manufacturing Corp.,* 476 F.2d 795, 801-03 (2d Cir.), *cert. denied,* 414 U.S. 908 (1973) (same).

The *Restatement of Torts* (1938), at §549, measures damages under this rule as

> (a) the difference between the value of the thing bought, sold or exchanged and its purchase price or the value of the thing exchanged for it * * *.

Thus, actual pecuniary loss rather than loss of bargain is the measure of damages:

> Under the [out-of-pocket] rule stated in * * * Clause [(a)] the re- **[9]** cipient of a fraudulent misrepresentation is entitled to recover from its maker only the actual loss which because of its falsity he sustains by his action or inaction in reliance upon it. If notwithstanding the falsity of the representation the thing which a vendee acquires is of equal or greater value than the price paid and he has suffered no harm through using it in reliance upon its being as represented, he has suffered no loss and can recover nothing. [*Restatement of Torts* §549, comment b at 110.]

The federal courts have identified two dates at which damages under the out-of-pocket rule may be ascertained. Quoting

from *Sigafus v. Porter,* 179 U.S. 116, 125 (1900), Judge Aldrich of the First Circuit has suggested that damages for a defrauded purchaser of securities coming within the coverage of §10(b) and Rule 10b-5 should be fixed as of the date of purchase:

> [T]he damages are to be reckoned solely by "the difference between the real value of the property at the date of its sale to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to the defendant's conduct, but not damages covering 'the expected fruits of an unrealized speculation' [*Smith v. Bolles,* 132 U.S. 125, 130 (1889)]." [*Janigan v. Taylor,* 344 F.2d 781, 786 (1st Cir.), *cert. denied,* 382 U.S. 879 (1965).]

Accord, Occidental Life Insurance Co. v. Pat Ryan & Associates, 496 F.2d 1255, 1264-65 (4th Cir.) (*semble*), *cert. denied,* 419 U.S. 1023 (1974); *Wolf v. Frank, supra,* 477 F.2d at 478-79; *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra,* 303 F.2d at 533 (dictum); **[10]** *Gottlieb v. Sandia American Corp.,* 304 F. Supp. 980, 991 (E.D. Pa. 1969), *aff'd in part, rev'd in part on other grounds,* 452 F.2d 510 (3d Cir.), *cert. denied,* 404 U.S. 938 (1971). The typical fact situation in these cases discloses an alleged fraudulent concealment or misrepresentation by a seller directed at the buyer-plaintiff only and not the public at large. Hence, the actual worth of the securities at the time of purchase by the plaintiff is readily ascertainable. *But see Gottlieb v. Sandia American Corp., supra,* 304 F. Supp. at 989-90.

The *Restatement of Torts* observes that there may be difficulty ascertaining the value of the article transferred in connection with a misrepresentation where the misrepresentation affects the market price of the article. This is particularly true with respect to publicly-traded securities:

> The value of the article is normally determined by the price at which it could be resold in an open market or by private sale if its quality or other characteristics which affect its value were known. However, the price which determines the value of the article is not necessarily the price which it would bring at the time the sale is made. In many cases this price is due to the widespread belief of other buyers in misrepresentations similar to that made to the person seeking recovery, as where the market price of securities, such as bonds or shares, is the result of widely spread misrepresentations of those who issue or market them. The fact that the market price is inflated or depressed by such misrepresentations is the important factor which makes the price fictitious * * *. [*Restatement of Torts* § 549, comment c at 111.]

Thus, where a defendant's fraudulent conduct is alleged, **[11]** as it is in this case, to have caused an artificial market of long duration, damages have been fixed, consistently with the *Restatement's* position, not at the date of purchase but rather at the date of discovery of the fraud. *See Esplin v. Hirschi,* 402 F.2d 94, 104-05 (10th Cir. 1968), *cert. denied,* 394 U.S. 928 (1969); *see also Chasins v. Smith, Barney & Co.,* 306 F. Supp. 177, 178 (S.D. N.Y. 1969) (failure by broker to disclose his position as a market-maker).

Although the Tenth Circuit has fixed damages as of the date that the buyer actually discovered, or should have discovered, the seller's fraud, *Richardson v. MacArthur,* 451 F.2d 35, 43-44 (10th Cir. 1971); *Esplin v. Hirschi, supra,* 402 F.2d at 104, we believe that under the allegations made in the instant case the public discovery of the fraud may be the proper date at which to ascertain damages. The circumstances may disclose that only then did the market reflect the true value of the stock, unaffected by what is alleged to have been the defendants' continuing fraud:

[V]alue is determined by their [*i.e.*, the securities'] market price after the fraud is discovered when the price ceases to be fictitious and represents the consensus of buying and selling opinion of the value of the securities as they actually are.

* * *

In the majority of stock transactions the person seeking recovery discovers the falsity of the misrepresentations at the same time that it becomes known to the investing public and, therefore, at a time when the price of the stock is no longer inflated or depressed by the same or similar misrepresentations. It may be, however, that he discovers the falsity of the representations either earlier or later than the general public. In the first situation, his loss is de- **[12]** termined by the actual value of the securities in question shown by their market price after the public discovery of the fraud brings the price into accord with the actual value. In the second situation, where the person seeking recovery does not learn of the falsity of the facts represented until sometime after the general public has discovered it, the value of the securities is fixed by the price at which they are selling at the time of his and not of the public's discovery. [*Restatement of Torts* § 549, comment c at 111, 112-13][5]

The American Law Institute's *Federal Securities Code* draft adopts in principle this same reasoning:

The measure of damages * * * is (A), if the plaintiff is a buyer, the difference between the amount that he paid and the value of the security determined as of the time specified in section 1402(e)(1) [*i.e.*, when, *inter alia*, all material facts became generally available to the investing public.] [ALI, *Federal Securities Code* § 1402(f)(1)(A) (Tent. Draft No. 2, 1973).]

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[5] The *Restatement (Second) of Torts* retains this formulation of the date for fixing damages. *Id.* §549, comment c. at 30-32 (Tent. Draft No. 11, 1965).

This proposed codification incorporates the common law rule for the date of ascertaining damages. ALI, *Federal Securities Code* § 1402(f)(1), comments (1)(b), (4)(b), (5)(b).[6]

[13] Thus, assuming, arguendo, the truth of Harris' claims that the actual value of the securities cannot be established at or near the date of purchase due to an artificially inflated market price of long duration attributable to defendants' fraudulent misrepresentations, Harris may be able at the trial to establish an alternate basis for recovery by introducing evidence of his damages as of the date of public discovery of the fraud.

If Harris cannot make out a case justifying this rule of damages, he may nevertheless be able to prove at trial that the actual value of the securities at the time of purchase was less than the market price that he paid for them.

The district court did not purport to rely on these damage rules in dismissing the action. We cannot say on the abbreviated record before us that plaintiff sustained no loss under either of these rules for ascertainment of damages. These matters will be before the district court upon the trial of this case. With this background, we turn to the issue of mitigation of damages, the basis on which the district court dismissed the case.

B. **Mitigation of damages.**

A defrauded buyer of securities may maintain an action **[14]** for damages under § 10(b) and, presumably, § 18(a), even though he continues to hold the securities. *Pfeffer v. Cressaty*, 223 F.

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[6] The appellees urge that *Morrow v. Schapiro*, 334 F. Supp. 399 (E.D. Mo. 1971), calls for the conclusion that the plaintiff in this case has suffered no compensable injury. We do not read *Morrow* to reach the issue presented here. In *Morrow*, the court assumed that the market value of the plaintiff's securities, which was greater than the purchase price, reflected—contrary to market value in the instant case—nothing other than the actual value of the securities and it reasoned that the plaintiff had therefore sustained no loss by misrepresentations that might have induced his purchase. *Id.* at 401.

Supp. 756, 758 (S.D. N.Y. 1963); *see Occidental Life Insurance Co. v. Pat Ryan & Associates, supra,* 496 F.2d at 1264-65; *Wolf v. Frank, supra,* 477 F.2d at 478; *Sackett v. Beaman,* 399 F.2d 884, 891 (9th Cir. 1968); *Johns Hopkins University v. Hutton,* 326 F. Supp. 250, 262 (D. Md. 1971), *aff'd in part, rev'd in part on other grounds,* 488 F.2d 912 (4th Cir. 1973), *cert. denied,* 416 U.S. 916 (1974). At common law, a defrauded purchaser of securities is under no duty to sell them prior to maintaining an action for deceit but may hold them for investment purposes if he chooses. *See Hindman v. First National Bank,* 112 F. 931, 935-36 (6th Cir.), *cert. denied,* 186 U.S. 483 (1902); *Hotaling v. A. B. Leach & Co.,* 247 N.Y. 84, 159 N.E. 870, 872 (1928); *Stephens v. Wheeler,* 193 Wis. 164, 213 N.W. 464, 468 (1927). Thus, Harris was under no duty to sell his AIC stock, for mitigation of damages or any other purpose, prior to commencing this action.

Where one has bought securities for long-term investment, it would be inappropriate to apply a rule requiring him to sell them prematurely for the benefit of the defrauding defendant. As we have noted, Harris' damages may be measured as of the date of public discovery of the fraud. Under those circumstances,

> [t]he plaintiff will not be able to avail himself of any further decrease in the value of the security after that date. So also the defendant should not be able to avail itself of any increase in the value of the stock after that date. This is the only method in which a consistent measure of damages can be obtained. [*Cant v. Becker & Co.,* 379 F. Supp. 972, 975 (N.D. Ill. 1974).]

[15] *Accord, O'Hara v. Derschug,* 241 App. Div. 513, 272 N.Y.S. 189, 198 (1934). *See also Beecher v. Able,* No. 66 Civ. 3471, CCH Fed. Sec. L. Rep ¶95,016 at 97,561 (S.D. N.Y. Mar. 17, 1975) (no need for plaintiff to mitigate damages in action under §11(a) of the Securities Act of 1933, 15 U.S.C. §77k

(a) (1970), by selling stock after statutory date for measurement of damages).

Consequently, we reject the appellees' contention that Harris was under a duty, after discovery of the fraud, to sell his AIC stock for the benefit of the appellees. By continuing to hold the stock after that date Harris has, in effect, made a second investment decision unrelated to his initial decision to purchase the stock. As the court observed in *Cant v. Becker & Co., supra,* 379 F. Supp. at 975, what happens after this second decision has no bearing whatsoever on the measure of plaintiff's damages.

II. Other Issues

Harris requests that, if we should reverse the district court's ruling on damages, we should also certify counts I and II as a class action. He contends that he is entitled as a matter of law to bring this case as a class action. We decline the invitation to decide at this juncture of the case whether it should proceed as a class action.

The district court dismissed the class action with respect to counts I and II because it had determined that Harris could recover no damages on his individual claims under these counts and therefore could not adequately represent all defrauded purchasers of AIC stock. Until the district court can reconsider Harris' adequacy as a representative of a proper class, we deem it inappropriate to evaluate the **[16]** propriety of a class action. Accordingly, the appeal on this issue is dismissed.

Harris also seeks our review of the district court's order dismissing without prejudice the allegations contained in count IV, a derivative action. As we have noted, this dismissal rested upon the failure of the appellant to plead specifically, as re-

quired by Fed. R. Civ. P. 23.1(1), that he was a stockholder at the time of the commission of the alleged wrongs by the directors and officers of the corporation.

According to Harris' contention, he has discussed certain of the events referred to in count IV in detail in other counts of his complaint. He contends that by reference to these allegations in other counts, count IV should be construed as alleging that he held stock at the time that defendants were guilty of misconduct in managing AIC.

This contention was apparently not presented to the district court, for the court stated that "the failure of the plaintiff to set out the date of the alleged wrongdoing or that any of the alleged wrongdoings continued after he [Harris] acquired his stock on August 4, 1969, * * * [caused the court to assume that] plaintiff cannot allege facts to support Count IV." [378 F. Supp. at 899.] Since the trial court entered this dismissal of count IV without prejudice, Harris is free to present this contention to the district court on remand and to seek leave to amend count IV to show that acts of misconduct by the directors and officers occurred after he had become a stockholder. Under these circumstances, we do not reach the merits of this issue raised by appellant-Harris.

[17] III. Summary

In summary, we reach no issue on this appeal other than that of damages. We reverse the grant of summary judgment on Harris' individual claims under counts I and II. Lest our opinion be misunderstood, we do not hold that plaintiff has made out a case entitling him to damages if he is able to prove fraudulent misrepresentations or omissions by the defendants.[7] We

[7] In order to recover any damages Harris must, on remand, prove all the elements for recovery under §10(b) and Rule 10b-5, *see, e.g.,*

hold only that on the record before us it cannot be said as a matter of law that Harris cannot collect damages even if he should establish the existence of the alleged fraudulent misrepresentations and omissions.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit

Myzel v. Fields, 386 F.2d 718, 733-37 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968), or §18(a), *see Heit v. Weitzen*, 402 F.2d 909, 914-16 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969). Among these elements is reliance by Harris upon the defendants' omissions and misrepresentations, more acurately characterized as causation in fact. *E.g., Clegg v. Conk*, 507 F.2d 1351, 1361 n.14 (10th Cir. 1974), *petition for cert. filed*, 43 U.S.L.W. 3531 (U.S. Mar. 4, 1975) (No. 74-1096). *See also Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974); *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1291-92 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970); *Werfel v. Kramarsky*, 61 F.R.D. 674, 681 (S.D. N.Y. 1974); *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 353 F. Supp. 264, 274-79 (S.D. N.Y. 1972), *aff'd*, 495 F.2d 228, 238-41 (2d Cir. 1974). *See generally* Note, *Reliance Requirement in Private Actions under SEC Rule 10b-5*, 88 Harv. L. Rev. 584, 587-96 (1975).

APPENDIX E

Section 10(b), Securities Exchange Act of 1934, 15 U.S.C. § 78j(b)

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 18(a), Securities Exchange Act of 1934, 15 U.S.C. § 78r(a)

Liability for misleading statements

(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by

such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

Reg. § 240.10b-5 (Rule 10b-5), Employment of Manipulative and Deceptive Devices

Reg. § 240.10b-5. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.